ULTRA VIRES CORPORATION LEASES.[1]

THE title of this paper sufficiently indicates its scope. I propose to consider this one question, namely, What is the legal effect of a lease which is *ultra vires*, or beyond the powers of the corporation executing it? The question appears to be a simple one, and the answer equally simple. In reality there lurks in the question itself a fallacy which renders it impossible to answer the question except by an elaborate explanation. The fallacy lies in the use of the term *vires*, or powers, which, if not necessarily ambiguous, is almost certain to create an ambiguous impression. A corporation is organized under a special charter or a general act which provides that the corporation may do certain things, and either expressly or by implication that it may not do other things. The corporation executes a lease which is not authorized by the provisions of its charter. This lease is said to be *ultra vires* or beyond the powers of the corporation. What is its legal effect? We are here concerned not with any question as to the construction of corporate charters, but simply with the effect of leases clearly unauthorized by such charters.

It is obvious that there are three possible objections to the validity of any *ultra vires* act.

The first is that the corporation has no power — that is to say, no legal capacity to produce the intended legal result.

The second is that the act in question is illegal because forbidden by some rule of law.

The third is that the act is a violation of the equitable right of the members of the corporation to have the property of the corporation applied exclusively to corporate purposes, as those purposes are determined by the charter or fundamental law of the corporation.

The third objection clearly has no force where all the members of the corporation assent to or ratify the act in question. The first two objections, however, are equally valid, whether the corporate act is sanctioned by the unanimous vote of the members, or by a mere majority. It is these two objections, then, in so far as they

[1] A paper read before the American Bar Association at Saratoga Springs, August 28, 1900.

bear upon corporate leases, that it is proposed to consider; leases having been selected for discussion because a lease is an instrument of so complex a character that it illustrates to the best advantage the present condition of the law of *ultra vires*.

A lease is, in the first place, a bilateral contract, imposing obligations on both lessor and lessee. In the second place, it is a conveyance by which a certain estate is conveyed by the lessor to the lessee. As the rules governing contracts differ in important particulars from those governing conveyances, *ultra vires* leases will be discussed first, as contracts, and second, as conveyances.

By hypothesis the lease is *ultra vires* or beyond the power of the corporation. "It is obvious," says Mr. Morawetz,[1] "that the words *powers* and *vires* are here used in the sense of authority or right, and not in the sense of ability." If this were obvious to everybody, the objection that the corporation has no legal capacity to make the lease would be eliminated, and the discussion of our subject simplified. Unfortunately, the word *powers* may mean either ability or authority, and is therefore ambiguous. The poverty of the vocabulary of our jurisprudence has often been lamented. We have in many cases only one word to express two or more different ideas — a misfortune which is aggravated, rather than mitigated, by the fact that in other cases we have several words to express only one idea. The ambiguity thus arising has been one of the most fruitful sources of uncertainty and confusion in our text-books and our judicial opinions. There may be some word in our legal vocabulary which, while capable of two meanings, is always used by lawyers in only one of those meanings. If there is such a word at the present day, only one thing can be said about it — the first lawyer who finds the other meaning more favorable to his client's case will use the word in that other meaning in his next argument. Inasmuch, then, as the word *powers* may be used in the sense of ability or capacity as well as in that of authority or right, we are not surprised to find that it has been so used. "To deny," says Mr. Morawetz,[2] "that corporations are able to enter into contracts and do frequently enter into contracts and do acts in excess of their chartered powers, is to deny an unalterable and self-evident fact." As opposed to this, we have the language of Mr. Justice Gray in Central Transportation Co. *v.* Pullman Co.,[3] who says that a contract *ultra vires* is unlawful and void "because the corporation by the law of its creation is *incapable* of making it.

[1] Corporations, § 648. [2] Ib. § 649 [3] 139 U. S. 24 (1891).

The objection to the contract is not merely that the corporation ought not to have made it, but that it *could not* make it." The question is, he continues, "whether the lease sued on is unlawful and *void for want of legal capacity* in the plaintiff to make it."[1] So also Lord Cairns in Ashbury Co. *v.* Riche:[2] "The question is not as to the legality of the contract; the question is as to the competency and power of the company to make the contract."[3] Such language shows clearly that the question of the legal capacity of the corporation as affecting the validity of its *ultra vires* acts is not to be determined simply by saying that corporations do enter into contracts in excess of their chartered powers, and that the sole objection to the validity of such contracts is their illegality. A married woman at common law could enter into a contract in one sense; she could sign, seal, and deliver a deed, but the deed was not her legal act, because she lacked legal capacity to contract. The corporation is a person by definition. Is the contractual capacity of this person general, like that of a natural person, or has the corporate person only partial or limited capacity? Chief Justice Marshall thought that the corporation derived all its powers from the act creating it, and was capable of exerting its faculties only in the manner which that act authorized.[4] The doctrine of special capacity has also found favor in some English cases.[5] A learned writer[6] in the Encyclopedia of the Laws of England,[7] speaking of the sphere of corporate powers defined by the charter, says, "outside this sphere it is stricken with impotence." The language of Mr. Justice Gray previously quoted has often been cited with approval, as, for example, by the Supreme Court of Illinois in a very recent case[8] which settled the law of that state in regard to *ultra vires* contracts. These citations show that the doctrine of special capacity is still entitled to respectful consideration. It is not, however, the prevailing view to-day, and in spite of the apparent authority in support of it, no dependence can be placed upon it. The objection to the doctrine is well stated by Sir Frederick Pollock[9] as follows: "All rights are in one sense creatures of the law, and it is in a special sense by creation of the law that

[1] 139 U. S. 59, 60 (1891). [2] L. R. 7 H. L. 653 (1875). [3] Ib. 672.

[4] Head *v.* Providence Insurance Co., 2 Cranch, 127, 169 (1804); Bank of U. S *v.* Dandridge, 12 Wheaton, 64, 99 (1827).

[5] Pollock, Contracts, Appendix D.

[6] Mr. E. Manson.

[7] Vol. xii. p. 360.

[8] National Home Building Ass'n *v.* Bank, 181 Ill. 35, 45 (1899).

[9] Contracts (2d Am. ed.), 121.

artificial persons exist at all. But when you have got your artificial person, why call in a second special creation to account for its rights?" The view now generally accepted, therefore, is that the contractual capacity of a corporation is as extensive as that of a natural person; that an act beyond the powers of a corporation is open to attack, not on the ground that it is impossible, but that it is illegal for the corporation to do the act.[1] An *ultra vires* lease, therefore, may be regarded simply as a corporate act which is illegal. Why is the act illegal, and what is the effect of the illegality?

The illegality of an *ultra vires* act may rest on one of three grounds: —

First. The act may be objectively illegal; that is, illegal for any person to do.

Second. The corporation may be forbidden by statute to do the act.

Third. *Ultra vires* acts may be illegal at common law, because regarded as injurious to the public welfare.

In the case of an *ultra vires* lease all three grounds of illegality may be present. If the corporation is under obligation to the public, as in the case of a railroad company, the alienation by lease or otherwise of property necessary to enable it to fulfil that obligation is clearly an illegal act. Again, if a statute forbids the lease, either expressly or by implication, it is unlawful. The English doctrine of the invalidity of *ultra vires* acts of companies rests upon the construction placed by the House of Lords, in Ashbury Co. *v.* Riche,[2] on the provisions of the Companies Act. The court, in construing that act, held that it prohibited the making of any contract not authorized by the memorandum of association. The American doctrine on this point is clearly stated by Mr. Justice Miller in Thomas *v.* Railroad Co.:[3] "Conceding the rule applicable to all statutes, that what is fairly implied is as much granted as what is expressed, it remains that the charter of the corporation is the measure of its powers, and that the enumeration of these powers implies the exclusion of all others."[4]

Apart from statute, however, is there any illegality in an *ultra vires* act? The ordinary answer to this question is in the affirmative. *Ultra vires* contracts are unlawful and void, it is said, on account of "the interest of the public that the corporation shall

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[1] Ib.; Morawetz, Corporations, § 648; George Wharton Pepper, 9 HARVARD LAW REVIEW, 255.

[2] L. R. 7 H. L. 653 (1875).

[3] 101 U. S. 71 (1879).

[4] Ib. 82.

not transcend the powers conferred upon it by law."[1] This doctrine has been so often reiterated by courts of the highest authority that it may seem presumptuous to question it. There are strong grounds, however, which cannot be set forth at length in this paper, for believing that the illegality of *ultra vires* acts, in every case where the act is not objectively illegal, may be shown to rest upon an express or implied statutory prohibition of such acts.[2] There is no stronger argument in support of this view than the different construction placed by the United States Supreme Court upon different provisions of the National Banking Act. A national bank is prohibited from lending money on real estate security, but a mortgage taken to secure such loans is enforceable.[3] The bank is prohibited from transacting any business except such as is incidental and preliminary to its organization, until authorized by the comptroller of the currency. A lease made in violation of this provision is illegal and void.[4] The same court has held, moreover, that the effect of an *ultra vires* act is a matter of statutory construction, in regard to which the federal courts are bound by the decisions of the supreme court of the state creating the corporation.[5]

On whatever grounds the illegality may rest, it is well settled that an *ultra vires* lease is illegal, and that no action can be brought upon the lease as a contract by either party.[6] It is immaterial in this connection whether it is the lessor or the lessee that lacks corporate power to make the lease;[7] although, if the lessee is a foreign corporation, the authorization of the lease by the legislature prevents either party from raising the question of its illegality.[8] In some jurisdictions, however, if the lessee has

[1] Central Transportation Co. *v.* Pullman Co., 139 U. S. 24, 48 (1891); McCormick *v.* Market Bank, 165 U. S. 538, 550 (1897); De La Vergne Co. *v.* German Savings Institution, 175 U. S. 40, 59 (1899).

[2] Riche *v.* Ashbury Co., L. R. 9 Ex. 224, 264 (1874).

[3] National Bank *v.* Matthews, 98 U. S. 621 (1878).

[4] McCormick *v.* Market Bank, 165 U. S. 538 (1897).

[5] Sioux City R. Co. *v.* North American Trust Co., 173 U. S. 99, 112 (1899).

[6] Thomas *v.* Railroad Co., 101 U. S. 71 (1879); Pennsylvania R. *v.* St. Louis, etc. R., 118 U. S. 290 (1886); Oregon Railway & Navigation Co. *v.* Oregonian Railway Co., 130 U. S. 1 (1889); Central Transportation Co. *v.* Pullman Co., 139 U. S. 24 (1891); McCormick *v.* Market Bank, 165 U. S. 538 (1897); Brunswick Gaslight Co. *v.* United Gas Co., 85 Me. 532 (1893). "It has been uniformly held that there could be no recovery on the lease itself." Brown, J., in De La Vergne Co. *v.* German Savings Inst., 175 U. S. 40, 59 (1899).

[7] Pennsylvania R. Co. *v.* St. Louis, etc. R., 118 U. S. 290 (1886); St. Louis, etc. R. Co. *v.* Terre Haute, etc. R. Co., 145 U. S. 393 (1892).

[8] Boston, Concord, etc. R. Co. *v.* Boston & L. R. Co., 65 N. H. 393 (1888).

occupied the premises under the lease he is liable for the rent.[1] This liability is said to rest upon estoppel. Such an application of the doctrine of estoppel has been often repudiated by the United States Supreme Court,[2] and there is a tendency to abandon it in some of the states where it previously prevailed.[3] An analysis of the nature of estoppel shows clearly that the doctrine can have no application to *ultra vires* acts. Estoppel is analogous to contract. In contract, responsibility springs from the promise acted upon by the promisee. In estoppel, responsibility springs from the representation of fact acted upon by the party claiming the estoppel. If we take the position that the invalidity of an *ultra vires* act is due to lack of corporate capacity, we are confronted with the principle that estoppel cannot affect contractual capacity as determined by personal status.[4] One who cannot be bound by a contract cannot be estopped from setting up the invalidity of that contract, as the cases of infants and married women show. On the other hand, if we regard an *ultra vires* act as illegal, we cannot escape the rule that there can be no estoppel against the law. If it is illegal for the corporation to do an *ultra vires* act, the act cannot be validated by the representation of the corporation itself. Instead of relying on an erroneous application of the doctrine of estoppel, it would be far more satisfactory if the courts which object to what Mr. Thompson,[5] with unnecessary asperity, calls "the abominable doctrine of *ultra vires*," would simply say that the violation of the law by a corporation which exceeds its charter powers is an irrelevant issue except in a direct proceeding by the state against the corporation. Nevertheless, the supposed harshness of the rule making all *ultra vires* acts illegal has often induced courts to sustain the validity of such acts at the expense of strict logic. Such a result is an unsatisfactory compromise between the theory that *ultra vires* contracts are void for illegality, and the theory that the illegality of such contracts is irrelevant in actions between private persons. Any real hardship from the application of the strict rule of illegality may be obviated

[1] Camden, etc. R. *v.* May's Landing, etc. R., 48 N. J. 530 (1886); Corpus Christi *v.* Central Wharf Co., 8 Tex. Civ. App. 94; 27 S. W. 803 (1894); Heims Brewing Co. *v.* Flannery, 137 Ill. 309 (1891); Bath Gas Light Co. *v.* Claffy, 151 N. Y. 24 (1896).

[2] St. Louis, etc. R. *v.* Terre Haute, etc. R., 145 U. S. 393 (1892); and cases *supra*, note 6 on page 336, *supra*.

[3] National Home Building Ass'n *v.* Bank, 181 Ill. 35 (1899).

[4] Bigelow, Estoppel (5th ed.), 604, 605.

[5] Corporations, vol. vii. § 8314 (1899).

by holding the officers of the corporation personally liable for breach of warranty of their authority to bind the corporation, as they have recently been held liable by the supreme court of Illinois in a case[1] where an *ultra vires* lease had been held void.

The lease being void for illegality, what remedy has the lessor if the lessee refuses to perform the covenants of the lease? Since the lessor has no contractual rights, he is to recover, if at all, against the lessee, upon equitable grounds; either on an implied assumpsit at law, or by filing a bill in equity for an accounting, as the case may be. There is a broad principle of equity, sometimes called the doctrine of unjust enrichment, that where one obtains property from another under a supposed contract, he cannot repudiate the contract and at the same time keep the property without paying anything for it. This quasi-contractual obligation on the part of the lessee to pay for what he has received under the lease, which in 1885 Mr. Justice Miller[2] said admitted of doubt, is now definitely established by the decision of the United States Supreme Court in the case of Pullman Co. *v.* Central Transportation Co.,[3] rendered in 1898. There is only one possible objection to recovery by the lessor for the use and occupation of the property on quasi-contractual grounds, an objection which has been pointed out by Mr. Pepper.[4]

It is this: — That an *ultra vires* contract is illegal, and that the maxim *in pari delicto potior est conditio defendentis* must prevent a recovery, even for the benefits actually conferred. The effect of this maxim and the inconsistency displayed in its application are hereafter considered. Hitherto, only one court which has treated an *ultra vires* lease as illegal seems to have refused the lessor recovery on quasi-contractual grounds, merely on account of the illegality. The Supreme Court of Ohio in one case,[5] it is true, held that there could be no recovery for the value of goods delivered under an *ultra vires* contract, but that was on the ground merely that the delivery was voluntary, with full knowledge of the facts. The Supreme Court of New York,[6] however, in 1872, held that the maxim *in pari delicto* prevented a recovery by the lessor for use and occupation under an *ultra vires* lease. Such an application of the

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[1] Seeberger *v.* McCormick, 178 Ill. 404 (1899).
[2] Pennsylvania Co. *v.* St. Louis, etc. R., 118 U. S. 318 (1898).
[3] 171 U. S. 138 (1898).
[4] 2 American Law Register, N. S. 299 (1865).
[5] Railway Co. *v.* Iron Co., 46 Ohio St. 44 (1888).
[6] Union Bridge Co. *v.* Troy, etc. R., 7 Lans. 240 (1872).

maxim is not without support in other cases of quasi-contractual actions;[1] but the maxim is an arbitrary one, and the rule allowing a recovery on equitable grounds for benefits received under an *ultra vires* lease has the weight of reason, as well as of authority, in its favor.[2]

The very great importance of the difference between allowing recovery on the contract, and allowing recovery on the theory of quasi-contract, is shown by the case of Pullman Co. *v.* Central Transportation Co., already cited. The Central Co. had leased to the Pullman Co. for ninety-nine years its entire plant and personal property, together with its contracts and patents. For fifteen years the lessee carried out the terms of the lease. After that time the lessee refused to pay the rent, and set up that the lease was *ultra vires* on the part of the lessor. In an action brought to recover the rent, the defence of *ultra vires* was sustained, and the lease declared illegal and void. The lessee then filed a bill to enjoin the bringing of suits for the collection of rents, and the lessor filed a cross-bill for an accounting of what the lessee had received under the lease. The Supreme Court sustained the lessor's cross-bill in an opinion which shows clearly the grounds on which the lessor is allowed to recover. The lease in that case was of personalty which had substantially disappeared in use. The Supreme Court allowed the lessor to recover the value of the cars, etc., transferred under the lease, at the time of the repudiation of the lease by the lessee, together with the cash received under the lease by the lessee, and interest thereon from the time of the repudiation of the lease. No recovery was allowed for the contracts or patents, because they had expired by lapse of time before the repudiation of the lease; nor for the use of the property transferred, or the earnings of such property in the hands of the lessee, because the rent paid prior to the repudiation of the lease was treated as full compensation for the use of the property under the lease. As millions were involved in this case, the decision as to the measure of recovery is of particular importance. The rule clearly established by the case is, that if the lease is of personalty, the lessor's right to recovery is limited to the value of the property transferred under the lease remaining in the hands of the lessee at the time the

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[1] Peck *v.* Burr, 10 N. Y. 294 (1851).

[2] Farmers' Loan & Trust Co. *v.* St. Joseph, etc. R., 2 Fed. Rep. 117 (1880); Greenville Compress Co. *v.* Planters' Compress Co., 70 Miss. 669 (1893); Nashua, etc. R. *v.* Boston, etc. R., 164 Mass. 222 (1895); Manchester, etc. R. *v.* Concord R., 66 N. H. 100 (1890).

lease is repudiated; to which interest from that date must be added. The case does not decide what is the measure of recovery where the lease is of real estate. From the principles laid down in the opinion, however, and supported by other authorities, it seems that the lessor should recover from the lessee the value of the use and occupation of the land from the time of the repudiation of the lease.

It is commonly said that an *ultra vires* lease is void. That the lease is void as a contract, we have already seen. Is it also void as a conveyance? This question cannot be satisfactorily answered in the present state of the law. There are many decisions, but they cannot be harmonized. Two general principles governing *ultra vires* conveyances are fairly well established. One is that a conveyance of property is not subject to attack on the ground that the contract leading to the conveyance or contained in it is illegal.[1] This rule has often been applied to corporation cases in decisions holding that the right of the corporation to make or accept a conveyance under its charter is not a question which can affect the title to the property.[2] The act of the corporation in making or accepting the conveyance in violation of its charter simply subjects its charter to forfeiture. The second rule involves a limitation of the first. It is that in case property conveyed is subject to a public use, like a railroad, the conveyance is void on account of the injury to the public, unless the conveyance is sanctioned by the state.[3]

On principle, therefore, one might say that a corporate lease is valid as a conveyance, although *ultra vires;* unless the lease is of a railroad or other property burdened with any duties to the public, when it is void. The authorities, however, do not permit of such clear generalizations. We must inquire in every case whether any legal effect has been given to the lease by the courts.

The first question that naturally arises, assuming the lease to be void, is, How can the lessor regain possession of the property demised after the lessee has entered thereon? If the lease is void

[1] Brooks *v.* Martin, 2 Wall. 70 (1863); Planters' Bank *v.* Union Bank, 16 Wall. 483 (1872).

[2] Cowell *v.* Springs Co., 100 U. S. 55 (1879); Jones *v.* Habersham, 107 U. S. 174, 188 (1882); Fritts *v.* Palmer, 132 U. S. 282 (1889).

[3] Thomas *v.* Railroad Co., 101 U. S. 83, Miller J.; Branch *v.* Jesup, 106 U. S. 478, Bradley, J.; Pennsylvania R. *v.* St. Louis, etc. R., 118 U. S. 290, Miller, J.; Central Transportation Co. *v.* Pullman Co., 139 U. S. 24, Gray, J.; Oregon R. *v.* Oregonian R., 130 U. S. 1, 23, Miller, J.; Snell *v.* Chicago, 152 U. S. 199, Brewer, J.; Brunswick Gaslight Co. *v.* United Gas Co., 85 Me. 532.

the lessor's rights are in no way affected by it. Therefore the lessor still has both right of property and right of possession. It would seem, therefore, that the lessor might regain possession of the property by the simple process of reëntry. This was the position taken by the lessor in the case of the American Union Telegraph Co. *v.* Union Pacific Railroad Co.[1] In that case the lessor, a railroad company, had made an *ultra vires* lease of its telegraph lines to the telegraph company, for which it received value. Fourteen years afterward the lessor undertook to rescind the lease on its own motion and to resume possession and control of the property, on the theory that the lease was void. The Circuit Court, McCrary, J., enjoined this action of the lessor. The court admitted the right of the lessor to rescind the lease, but said: "The right of rescission does not justify the railroad company in taking possession except by lawful means. A party who is in actual possession of the property, claiming under color of title, is not to be ousted except by means provided by law, and such possession the court will protect by injunction from disturbance by any other means." The lessor was given leave to file a cross-bill tendering a return of the consideration and praying for a cancellation of the lease. In other cases[2] involving the same questions, the lessor was enjoined from interfering with the lessee, because the latter had expended money on the property, so that the court regarded the lessor and the lessee as joint owners. These cases support the view that an *ultra vires* lease of property burdened with public duties is not absolutely void because *ultra vires*, but gives the lessee who enters under it a right of possession which can only be taken away by proper legal proceedings. On the other hand, where the lessor had taken possession of the property, and had filed a bill for the rescission of the lease, Foster, J.,[3] refused to dissolve an injunction which the lessor had obtained against the lessee's interference with the property. To reconcile the decision of Judge Foster with that of Judge McCrary is a difficult task.

Again, in a Tennessee case, Mallory *v.* The Hanaur Oil Works,[4] decided in 1888, there was an *ultra vires* contract by which four

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[1] 1 McCrary, 188 (1880).

[2] Western Union Tel. Co. *v.* Union Pacific R., 1 McCrary, 558 (1880); Western Union Tel. Co. *v.* Burlington, etc. R., 3 McCrary, 130 (1882). See, also, 1 McCrary, 581.

[3] Central Branch U. P. R. *v.* Western Union Tel. Co., 1 McCrary, 551 (1880).

[4] 86 Tenn. 598.

corporations turned over to certain trustees for three years all their property. One of the corporations subsequently repudiated the agreement and brought an action of unlawful detainer. The court held the agreement to be *ultra vires*, and restored the property to the plaintiff. On general principles it would seem that if an action of unlawful detainer can be sustained by the lessor, a right of reëntry, at least by peaceable means, is to be implied. It is to be noted that in the Tennessee case the lease was made by an ordinary business corporation, so that, on principle, one might expect it to be upheld; while in the case of the Telegraph Co. above cited the lease was a conveyance of property burdened with public duties, which, on principle, might be regarded as absolutely void.

Although the courts are likely to deny to the lessor the right to recover property demised by its own act, the statement has often been made, as in the case of the Telegraph Co. above cited, that the courts will restore to the lessor the property demised by an *ultra vires* lease. As in the case of the Telegraph Co. the lessor was given leave to file a cross-bill tendering a return of the consideration and praying for a cancellation of the lease, so in the case of the Memphis and Charleston Railroad Co. *v.* Grayson,[1] decided by the Supreme Court of Alabama in 1890, the right of the lessor to file a bill for the cancellation of the lease was distinctly upheld. Even Mr. Justice Gray, who has since taken the strongest ground against relieving the lessor from an *ultra vires* lease, said in 1890, in the case of the Central Transportation Co. *v.* Pullman Co.: "The courts, while refusing to maintain any action upon the unlawful contract, have always striven to do justice between the parties, so far as could be done consistently with adherence to law, by permitting *property or money*, parted with on the faith of the unlawful contract, *to be recovered back*."[2] Other language by eminent judges might be quoted in support of this view. Mr. Justice Miller said in 1886: "The courts have gone a long way to enable parties, who had parted with property or money on the faith of such contracts, to obtain justice by recovery of the property or the money specifically."[3] So in the case of Pullman Co. *v.* Central Transportation Co., Mr. Justice Peckham, speaking of the liability of the lessee for property received under an *ultra vires* lease, said that such "liability is based only upon an implied promise to *return* or make compensation therefor. This implication of a promise would not arise until *one or the other party* chose to terminate the lease."[4]

[1] 88 Ala. 570.
[2] 139 U. S. 24, 60.
[3] Salt Lake City *v.* Hollister, 118 U. S. 263.
[4] 171 U. S. 138, 159 (1898).

In the case of *ultra vires* leases of railroad companies and other similar corporations, there is high authority for saying that there is not only a right on the part of the lessor to claim rescission of the lease, but a positive duty. In the well-known case of Thomas *v.* Railroad Co.,[1] decided by the United States Supreme Court in the October term, 1879, a railroad company had made an *ultra vires* lease of its road to another company. The lessor resumed possession of the property before the expiration of the lease, and the lessee brought an action for damages on account of the refusal of the lessor to arbitrate as to the value of the unexpired term of the lease. The lease contained a provision for arbitration in case of resumption of possession by the lessor. The Supreme Court of the United States, in an opinion by Mr. Justice Miller, held that the contract sued upon was forbidden by public policy. "Having entered into the agreement," says Justice Miller, "it is the duty of the company to rescind or abandon it at the earliest moment. This duty was independent of the clause in the contract which gave them the right to do it." This statement of Mr. Justice Miller's was *obiter dictum*, but has often been cited with approval.

The positive language used in this case was reiterated by the same judge in 1886 in the case of the Pennsylvania Co. *v.* St. Louis, etc. Railroad Co.[2] Mr. Justice Miller's opinion on this point has often been quoted,[3] and seems to have been generally accepted as a correct statement of the law; and in the latest book on corporations, the seventh volume of Mr. Thompson's Commentaries,[4] published in 1899, the continuing duty of rescission by the lessor, in the case of an *ultra vires* lease by a so-called public corporation, is emphatically set forth. The reason for this doctrine is obvious. If the lease is void because it is injurious to the public interest, then the public interest is best promoted by a rescission of the lease; which the lessor ought to seek, and which the courts, of course, ought to grant. This apparently reasonable doctrine, however, has been rejected by the Supreme Court of the United States. In the case of the St. Louis, etc. Railroad Co. *v.* Terre Haute, etc. Railroad Co.,[5] decided in 1892, the plaintiff had leased its railroad to the defendant for nine hundred and ninety-nine years. The lessee had been in possession, paying the stipulated rent for seventeen years without taking any steps to rescind the lease, when the lessor filed a bill for the cancellation of the lease and the restoration of the

[1] 101 U. S. 71.
[2] 118 U. S. 290, 317.
[3] As in Newcastle Northern R. *v.* Simpson, 21 Fed. Rep. 533 (1884).
[4] § 8331.
[5] 145 U. S. 393 (1892).

property, on the ground that the lease was illegal and that the parties were *in pari delicto.* The reasoning of Mr. Justice Miller proved insufficient to overcome the force of the maxim, *in pari delicto potior est conditio defendentis.* Now, whatever may be the value of legal maxims, they cannot be accepted as the safest premises from which to draw conclusions. A legal maxim is always a generalization and is usually expressed in a more or less attractive form. Unfortunately, our law is made up of particular cases from which generalizations can only be drawn with the greatest care. The more glittering the generalization, therefore, the greater the probability of its inaccuracy. Wise saws are good companions, but poor substitutes for modern instances. Of all the legal maxims which have confused instead of simplifying the law, there is none more troublesome than this old saw, *in pari delicto potior est conditio defendentis.* The general meaning of the maxim is clear. Not only will a court refuse to enforce an illegal contract, but it will also take into account the illegal conduct of the parties when either appeals for any relief in connection with the illegal transaction, and if it sees fit, will leave the parties where it finds them. In many cases, of course, this is sound public policy, but we have never been able to reach any satisfactory and consistent conclusions as to the extent to which this maxim should be applied. There is one qualification in the maxim itself — it does not apply unless the parties are *in pari delicto.* Therefore, if one party is induced by the fraud or duress of the other to enter into an illegal contract, his case is not affected by the maxim.[1] In a New Hampshire case, decided in 1890, Manchester, etc. Co. *v.* Concord Railroad Co.,[2] the court held that a railroad company which had leased its road to another was not *in pari delicto* with the lessee company. In the case of the St. Louis Railroad *v.* Terre Haute Railroad, the United States Supreme Court held that the lessor and the lessee companies were *in pari delicto.* It is difficult to understand the reasoning of the New Hampshire court in this regard, or to see how there can be any legal difference in the iniquity of the lessor and the lessee companies. Certainly the United States Supreme Court has shown no disposition to weigh the respective demerits of the parties to an *ultra vires* railway lease.

Another limitation upon the maxim *in pari delicto* has been suggested by Mr. Keener,[3] who says that "if the illegality is *malum prohibitum* merely, the plaintiff can, so long as the contract

[1] 145 U. S. 407 (1892). [2] 66 N. H. 100 [3] Quasi-Contracts, 259.

remains executory, disaffirm the contract and recover the money paid or property delivered thereunder." This exception is also upheld by Mr. Pepper.[1] The exception, however, is of uncertain authority and of more uncertain application. According to Sir William Anson,[2] the law cannot be said to be satisfactorily settled on this point. He and Mr. Leake [3] agree that where the illegal contract has been partly performed, the maxim *in pari delicto* applies, and there is American authority to the same effect.[4] Mr. Keener and Mr. Pepper, however, appear to take the opposite view. The whole trouble, both in regard to the maxim and in regard to the exception, springs from one source. In considering the question of illegality as affecting the rights of the parties to a given case, the object of the court is to protect the public interest. Its inquiry, therefore, ought to be, what method of dealing with the present situation will best tend to prevent the injurious results to the public which are supposed to flow from every illegal transaction. In many cases, if the court were to grant rescission of the transaction, it would interpose the most effective barrier against the consequences of the illegal act. There is excellent authority for saying that the decisions of the courts in reference to such illegal transactions, where the question does not arise on the illegal contract itself, should be determined by the practical consequences of the decision.[5] Mr. Justice Story,[6] in discussing the maxim *in pari delicto*, says: "But in cases where the agreements or other transactions are repudiated on account of their being against public policy, the circumstance that the relief is asked by a party who is *particeps criminis* is not in equity material. The reason is that the public interest requires that relief should be given, and it is given to the public through the party." This reasoning of Mr. Justice Story was deemed conclusive by the Supreme Court of New York,[7] and is not answered by the opinion in St. Louis Railroad *v.* Terre Haute Railroad.[8] A Texas court, in following that opinion, answers Story's statement of the law by

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[1] 9 HARVARD LAW REV. 257; 2 American Law Reg. (N. S.) 296.

[2] Contracts (8th ed.), 217.

[3] Digest of Contracts, 673.

[4] Singer Mfg. Co. *v.* Draper, 52 S. W. 879, Tenn. (1899).

[5] Block *v.* Darling, 140 U. S. 234 (1891); New Castle Northern R. *v.* Simpson, 21 Fed. Rep. 533, 537 (1884); Tate *v.* Commercial B'l'd'g Ass'n, 33 S. E. 382 (1899), Va.; Story, Equity Jur. § 298.

[6] Equity Jur. § 298.

[7] Union Bridge Co. *v.* Troy, etc. R., 7 Lans. 240 (1872).

[8] 145 U. S. 393.

saying: "Where the plaintiffs' conduct should preclude them from attacking such a transaction for their private advantage, they should not be allowed to represent the public interests which they have sacrificed, and to determine for themselves when and how they should be set up. Here the illegal thing consists in the parting with the control of the road." [1] This answer is unsatisfactory. The illegality of the lessor's conduct consists not merely in parting with the control of the road, but in its continual refusal to perform its duties to the public, and the attempt of the lessor to resume the performance of its duties is one which the courts would naturally be expected to encourage. The fact is, altogether too much importance has been attached to the arbitrary maxim *in pari delicto*. The courts, in striving to avoid the consequences of that maxim by making exceptions thereto, often avoid the Scylla of injustice only to wreck their legal theories on the Charybdis of inconsistency. The trouble is that, in attempting to protect the public interest, the courts have attempted to draw distinctions with reference to the previous conduct of the parties, instead of with reference to the probable or natural effect of the decree asked for upon the public welfare, and such distinctions have proved impossible of satisfactory or consistent application. The more extensive the comparison of the cases in which the maxim *in pari delicto* has been applied,[2] the clearer becomes the impossibility, in this country at least, of reaching any satisfactory general conclusions from the maxim. Thus, it is generally understood that in a case where the maxim *in pari delicto* applies, there can be no recovery for benefits conferred on the theory of an implied contract.[3] In the case of an *ultra vires* lease, the maxim *in pari delicto*, according to the decisions of the United States Supreme Court, will prevent a decree of rescission, even of the executory portion of the lease, so long as the lessee does not violate the provisions of the lease; but the maxim does not prevent a recovery on quasi-contractual grounds for the use and occupation of the premises under the lease, — an inconsistency which was pointed out some years ago by Mr. Pepper.[4] It is a poor maxim, however, that does not

[1] Olcott *v.* International, etc. R., 28 S. W. 728 (1894), Tex. Civ. App.

[2] *Cf.* Brooks *v.* Martin, 2 Wall. 70; Planters' Bank *v.* Union Bank, 16 Wall. 483; Block *v.* Darling, 140 U. S. 234; Spring Co. *v.* Knowlton, 103 U. S. 49; Herman *v.* Jeuchner, 15 Q. B. D. 561; *Re* Great Berlin Stbt. Co., 26 C. D. 616; Kearley *v.* Thompson, 24 Q. B. D. 742; Kirkpatrick *v.* Clark, 132 Ill. 342; St. Louis, etc. R. *v.* Terre Haute, etc. R., 145 U. S. 393; Union Bridge Co. *v.* Troy, etc. R., 7 Lans. 240.

[3] 2 American Law Reg. (N. S.) 306.

[4] Ib. 296.

work both ways; and this same maxim led the Supreme Court of New York [1] to exactly the opposite conclusion, namely, that the court ought to rescind the lease upon the application of the lessor, but that it ought to award the lessor no compensation for the use and occupation of its property. Both these opposite conclusions are entitled to respect; but they do not increase one's respect for the arbitrary maxim on which both are founded; and they show clearly the necessity of some restatement of the law as to the effect of the illegality of a contract on other legal relations of the parties to that contract.

The maxim *in pari delicto* is not in any case a bar to the equitable rescission of the lease as against stockholders in the lessor corporation who have not assented to or ratified the lease. Any *ultra vires* act of the corporation is an infringement of the equitable rights of the non-assenting stockholders. A corporation may sue to rescind such act, as the representative of the injured stockholders,[2] and if it refuses to sue, such stockholders may file a stockholders' bill for rescission,[3] making the corporation a party defendant. If, however, the rights of the dissenting stockholders are barred by laches or any other defence, neither they nor the corporation can file a bill for rescission;[4] unless the corporation itself is given that right on grounds of public policy.[5] The maxim *in pari delicto* does not, it seems, prevent rescission of the contract in any case where the corporation sues in a representative capacity, as in the case of the trustees of a charitable fund,[6] or in the case of a municipal corporation.[7]

If a court will not entertain a bill in equity for the rescission of an *ultra vires* lease, it is probable that it will also refuse to entertain an action at law for the recovery of the property. This does not necessarily follow, however. The maxim *in pari delicto* operates as a bar to the plaintiff's recovery, it is commonly said, only where the plaintiff is compelled to establish his case by proving that he himself has acted illegally. In the case of a bill in equity

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[1] Union Bridge Co. *v.* Troy, etc. R., 7 Lans. 240 (1872).

[2] Great Northwestern Central R. *v.* Charlebois, 1899, A. C. 114 (P. C.); Olcott *v.* International, etc. R., 28 S. W. 728 (1894), Tex. Civ. App.

[3] Board of Commissioners *v.* Lafayette, etc. R., 50 Ind. 85 (1875).

[4] St. Louis, etc. R. *v.* Terre Haute, etc. R., 145 U. S., 393 (1892); Boston, Concord, etc. R. *v.* Boston & Lowell R., 65 N. H. 393 (1888); Olcott *v.* International, etc. R., 28 S. W. 728 (1894), Tex. Civ. App.

[5] Memphis, etc. R. *v.* Grayson, 88 Ala. 570 (1890).

[6] Auburn Academy *v.* Strong, Hopk. Ch. 278 (1824).

[7] Detroit *v.* Detroit City R., 56 Fed. Rep. 868, 892 (1893).

to rescind an *ultra vires* lease, the illegality must appear in the bill itself. If, however, the lessor brings an action of ejectment, or of forcible entry, against the lessee, it seems unnecessary for the plaintiff to offer the lease in evidence. The plaintiff is not seeking to recover on the lease, but on the ground of ownership of the property to which the lessee has no title or right of possession. If, then, the plaintiff establishes his ownership and the defendant's ouster, the plaintiff has made a *prima facie* case. If the *ultra vires* lease is treated as a valid conveyance, it is, of course, a sufficient defense to the lessee; but if the lease be held void as a conveyance, the only ground on which it is admissible as evidence for defendant is that public policy requires the admission of the lease in order to prevent the wicked plaintiff from obtaining any assistance from the courts. Unless the lease should be unnecessarily introduced in evidence by the plaintiff, the plaintiff's case does not rest upon the illegal lease, and he might perhaps recover in spite of the maxim *in pari delicto*. Recovery in an action at law for unlawful detainer has been allowed the lessor in Tennessee.[1] A Texas court, however, has held that the lessee may set up the illegality of the lease as a defence, even though the lessor is able to make a *prima facie* case without showing any illegality in the transaction.[2] Mr. Justice Gray, in St. Louis Railroad *v.* Terre Haute Railroad,[3] said that where the lessee does not repudiate the lease, the case is one in which "the court will not disturb the possession of the property that has passed under the contract, but will refuse to interfere as the matter stands."[4] On the other hand, in the later case of Pullman Co. *v.* Transportation Co.,[5] Mr. Justice Peckham said that "the use of the property is lawful as between the parties so long as the lease was not repudiated by either,"[6] implying that the lessor as well as the lessee had a right to repudiate the lease. All that the case of St. Louis Railroad *v.* Terre Haute Railroad decides is that a court of equity will not grant relief to the lessor so long as the lessee does not repudiate the lease. The right of the lessor to repudiate the lease and assert his original rights in a court of law has not yet been determined by the Supreme Court of the United States; although Mr. Justice Gray's opinion is opposed to the recognition of such a right. Whether the lessor can rescind the lease or not, it seems that in *quo warranto* proceedings by the

[1] Mallory *v.* Hanaur Oil Works, 86 Tenn. 598 (1888).
[2] Olcott *v.* International, etc. R., 28 S. W. 728 (1894), Tex. Civ. App.
[3] 145 U. S. 393.
[4] Ib. 409.
[5] 171 U. S. 138.
[6] Ib. 160.

state, the lease may be declared void;[1] and the making of the lease has been held an offence so grave as to warrant the forfeiture of the corporation charter.[2]

What has been said previously with reference to the recovery of the demised property by the lessor refers only to the case where the lessor seeks to repudiate the lease. We have now to consider the result where the lease is terminated by lapse of time or by breach of condition. It is probable that the lessor has the same right to recover the property upon the termination of an *ultra vires* lease, or upon a breach of condition of such lease by the lessee, that it would have if the lease were valid. In a case in the Supreme Court of Washington, Hall, etc. Co. *v.* Wilber,[3] decided in 1892, the lessor brought an action for unlawful detainer against the lessee, who had refused to pay his rent. The complaint set out the lease, and lack of corporate power in the lessor to make the lease was held to be no defence to the action. The Supreme Court of the United States, in the case of St. Louis Railroad *v.* Terre Haute Railroad,[4] clearly intimated that the recovery of the property, which was refused the lessor in that case, would be allowed if the lessee repudiated the lease. So, in the case of Pullman Co. *v.* Transportation Co.,[5] Mr. Justice Peckham's statement that the use of the property was lawful as between the parties so long as the lease was not repudiated by either, implies that upon breach of condition by the lessee such use would become unlawful. On the other hand, there is a case decided by the Circuit Court of Appeals for the sixth circuit,[6] involving an application of the maxim *in pari delicto* which it is difficult to reconcile with any of the other cases. In that case, the Merz Capsule Company had entered into an *ultra vires* contract. In pursuance of this contract, this company conveyed its property to the United States Capsule Company, taking back a lease of the premises for a few weeks. After the expiration of the lease the lessee continued in possession, and refused to surrender possession to the lessor, at the same time tendering back what it had received from the lessor, and demanding complete rescission. The lessor thereupon entered upon the premises and undertook to

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[1] State *v.* Atchison, etc. R., 24 Neb. 143 (1888).

[2] Eel River R. *v.* State, 57 N. E. 388 (1900), Ind.

[3] 4 Wash. 644.

[4] 145 U. S. 393.

[5] 171 U. S. 138.

[6] McCutcheon *v.* Merz Capsule Co., 37 U. S. App. 586 (1896).

remove the machinery, and the lessee filed a bill praying that the *ultra vires* contracts and conveyances should be cancelled, and the lessor enjoined from interfering with the lessee's possession. The lessor filed a cross-bill, setting up the instruments in question as legal instruments, and praying for specific performance of the agreements therein contained. The cross-bill was dismissed and a decree entered under the original bill, quieting title in the lessee, and enjoining the lessor from the commission of trespass. This decree was affirmed by the Circuit Court of Appeals. The court quoted the language of Mr. Justice Gray in St. Louis Railroad *v.* Terre Haute Railroad:[1] "If the contract is illegal, affirmative relief against it will not be granted at law or in equity unless the contract remains executory." The court went on to say: "The contract in the case at bar between parties *in pari delicto* is in a large degree still executory." Now, in the case of St. Louis Railroad *v.* Terre Haute Railroad, only seventeen years of the nine hundred and ninety-nine year lease had elapsed, yet the Supreme Court refused the lessor rescission as to the remaining part of the term. In the case of McCutcheon *v.* Capsule Co., the complainant had in the first place executed a deed to the defendant, which, according to the decisions of the Supreme Court, transferred the title to the property to the defendant, and had also taken back a lease from the defendant, which had expired. Yet after all this had been done, the court held that the transaction was so far *executory* as to entitle the complainant to relief, in spite of the maxim *in pari delicto.*

A few points with reference to the effect of an *ultra vires* lease upon the rights of third parties remain to be mentioned. One rule well established is that the lease cannot relieve the lessor corporation of any duties imposed upon it by law; so that a railroad company, leasing its road without legislative sanction, remains responsible for the proper operation of the road.[2] Another rule is that the invalidity of the lease does not affect any obligation assumed by the lessee, as carrier, warehouseman, or other bailee.[3] Another possible collateral effect of the doctrine of *ultra vires* is shown in the case of Great Northern Railroad *v.* Eastern Counties Railroad.[4] The plaintiff in that case had an agreement

[1] 145 U. S. 393.

[2] Railroad Co. *v.* Brown, 17 Wall. 445, 450 (1873); 7 Am. & Eng. Encyc. of Law (2d ed.), 747.

[3] McCluer *v.* Manchester, etc. R., 13 Gray, 124 (1859).

[4] 9 Hare, 306 (1851).

with the defendant by which the defendant allowed the use of its lines to connect plaintiff's lines with those of a third railroad, which had been practically leased by the plaintiff under an *ultra vires* agreement. The plaintiff sought an injunction to prevent the defendant from interfering with the free passage of the plaintiff over the defendant's lines to the leased railroad. The court refused the injunction on grounds of public policy.

The results of the foregoing examination of the authorities may be summed up as follows: —

1. The lease as a contract is void, and no action can be brought upon it; except in those jurisdictions where the defence of *ultra vires* is excluded in actions on contracts fully or partially executed, on the alleged ground of estoppel.

2. The lessor is entitled to compensation for the use of its property under the lease, the amount of such compensation being determined by equitable principles.

3. An *ultra vires* lease by an ordinary business corporation, to which all the stockholders assent, may be upheld on general principles as a valid conveyance of the property; but the law is uncertain.

4. An *ultra vires* lease of a railroad, or other property burdened with duties to the public, on principle might be regarded as void. So far as the obligations of the lessor to the public are concerned, the lessor is relieved of no obligation by the lease; but as between the lessor and the lessee, the relative rights of the parties cannot at present be clearly defined, on account of the uncertainty as to the application of the maxim *in pari delicto*, and of the greater uncertainty whither the courts will be carried by public policy — once called an unruly horse, but at the present day displaying the even more unruly disposition of an automobile. It seems, however, that the lessor may not forcibly dispossess the lessee; and it is uncertain, in the federal courts, at least, whether the lessor has any remedy for the recovery of the property, so long as the lessee observes the conditions of the lease.

5. If there is a breach of condition of the lease, as in the case of repudiation by the lessee, the lessor seems to have the same right to recover the property that it would have in the case of a breach of condition in a valid lease.

There are two theories with reference to the nature of law, each upheld by able advocates. One is that the law is a collection of principles which are illustrated by the decisions of the courts. The other is that law is a natural science; and that its principles

are to be ascertained by studying the actions of courts, as the principles of physiology are ascertained by studying the action of living organisms. Whether one regards judicial decisions as the foundation of legal principles, or as mere illustrations of those principles, it must be conceded that the law of corporations at the present time suffers from an embarrassment of riches. We have more "principles" and more decisions than we can harmonize into a system of corporation law. The conflict of opinion and of authority on one question only has been shown in this paper. That conflict will necessarily continue during the formative period of corporation law, until, by the survival of the fittest, harmony of theories and decisions is obtained, and the law of corporations, following the example of the law of real property, becomes crystallized into a system of fixed rules, alterable only by legislation.

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